BEFORE

THE PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

DOCKET NO. 2019-233-A

IN RE:

Procedure to Address Treatment of Deferrals (See Page Number 5 of Order No. 2019-341)	**JOINT RESPONSE OF DUKE ENERGY CAROLINAS, LLC AND DUKE ENERGY PROGRESS, LLC**

Duke Energy Carolinas, LLC ("DEC") and Duke Energy Progress, LLC ("DEP") (collectively, "Duke Energy" or "Companies") file this joint response to comments filed in the above-referenced proceeding, which addresses issues relating to the creation and treatment of deferrals. In particular, this joint response addresses comments filed by the South Carolina Office of Regulatory Staff ("ORS") and Nucor Steel-South Carolina ("Nucor").

I. Response

A utility's cost recovery in a rate case is based on expenses incurred during the historic test year, as adjusted based on known and measurable changes occurring after the test year. Because of that dynamic, rates put in place following a rate case are generally presumed to recover a utility's expenses based upon what was incurred in the test year. However, sometimes there are expenses which are outside of what was included in current rates. In that scenario, utilities may file for approval to defer such costs until the time they can be included in rates. This has worked well in South Carolina for enabling new investments in capital projects like generating plants and technological advancements, as well as storm repair and regulatory compliance for new statutes and laws requiring action by utilities where such expenses were not included in prior cases.

Absent a deferral ability, utilities either have disincentive to make any expenditures not recovered by current rates, or incentive to file frequent rate cases—as to do otherwise would be to forego recovery. As a partial solution to these issues, when the appropriate circumstances exist and customers would benefit, the Commission can, on a case-by-case basis, authorize the use of deferral accounting in order to bridge the gap between the incurrence of unusual or extraordinary costs and when new rates from a rate case can be implemented to recover those costs. With these general principles in mind, the Companies provide the following responsive comments.

A. The Commission should issue guidelines concerning deferrals rather than promulgate a regulation.

As a preliminary matter, the Companies agree with ORS that the Commission should establish guidelines—not rules or regulations—allowing the Commission the flexibility to consider requests for accounting orders on a case-by-case basis. As ORS explains in its comments, the key distinction between policy guidance and a regulation is whether the agency's promulgation establishes a binding norm, i.e., whether the agency may exercise discretion to follow or not to follow its stated policy in individual cases. In this case, given the fact-specific nature of deferrals and utility cost-recovery in general, the Companies agree with ORS that deferrals should be considered on a case-by-case basis and that the Commission should not be constrained by a regulation that could prevent it from exercising its discretion regarding specific accounting order requests.

In their comments, the Companies provided guidelines that utilities could address, and the Commission could consider, in proposing deferral requests, enumerated for convenience below:

1. Whether the expense being incurred by the utility is significant to the utility.
2. Whether the expense is out of the ordinary.

3. Whether the expense is necessary, could not have been reasonably anticipated by the utility, or is beyond the utility's control.
4. Whether the expense is of a nature that complete cost recovery cannot be captured through traditional ratemaking.
5. Whether the expense is currently included in rates.
6. Whether the denial of the accounting request could adversely affect the utility's earnings as compared to the most recently allowed return set by the Commission.
7. Whether the deferral results in procedural efficiency.
8. Whether the deferral will be included in a rate case within a reasonable time.
9. Whether the deferral helps advance any technological improvement, modernization or compliance with applicable law or regulation.
10. Whether the cost being deferred will ultimately create customer savings or operational benefits from what would otherwise occur absent the expenditure.
11. Any other criteria deemed important by the Commission based upon the facts and circumstances for each individual request.

As explained in the Companies' comments, these guidelines are not intended to be requirements; they may not each be applicable to every deferral request, and in some cases, they may be in tension with one other. However, the Companies submit that these types of considerations, individually or in multiples, are relevant to and should be considered in evaluating requests for deferral accounting treatment.

B. The appropriate evidentiary standard is a preponderance of the evidence.

The Companies challenge ORS's position that the Commission's standard for evaluating accounting order requests should be the "clear and convincing" standard. Instead, the correct

standard for evaluating whether deferral accounting is appropriate is a preponderance of the evidence. The relevant statutes "do not indicate a legislative intent to apply the clear and convincing standard" to decisions by the Commission. *Carmax Auto Superstores W. Coast, Inc. v. S.C. Dep't of Revenue*, 397 S.C. 604, 611-12 (S.C. App., 2012) ("[T]he statutes do not indicate a legislative intent to apply the clear and convincing standard. Accordingly, we reverse the ALC's determination that CarMax West had the burden of proof, and remand for a reconsideration of all issues applying the preponderance of the evidence burden of proof."). The Commission, as an administrative agency, is instead bound by the S.C. Administrative Procedures Act, which stipulates that "[u]nless otherwise provided by statute, the standard of proof in a contested case is by a preponderance of the evidence." S.C. Code Ann. § 1-23-600(A)(5). The South Carolina Supreme Court has further opined on the appropriate standard of proof in an administrative proceeding:

> Absent an allegation of fraud or a statute or a court rule requiring a higher standard, the standard of proof in administrative hearings is generally a preponderance of the evidence . . . . Utilization of a higher level of proof is ordinarily reserved for situations where particularly important individual interests or rights are at stake, such as the potential deprivation of individual liberty, citizenship, or parental rights.

Anonymous (M-156-90) v. State Bd. of Med. Exam'rs, 329 S.C. 371, 375 (1997). *Cf. Santosky v. Kramer*, 455 U.S. 745, 756 (1982) ("This Court has mandated an intermediate standard of proof 'clear and convincing evidence'—when the individual interests at stake in a state proceeding are both 'particularly important' and 'more substantial than mere loss of money.'"). Because there is neither legislative intent that supports a higher standard of proof, nor "important individual interests or rights" that may be deprived by the Commission's approval of a deferral request, the preponderance of the evidence standard governs the Commission's decisions on deferral requests.

C. Costs need not be both non-recurring and unexpected to be eligible for deferral treatment.

The Companies disagree with ORS's position that, to be eligible for an accounting order, the costs at issue should be "nonrecurring in nature **and** unexpected in the normal course of business operations." ORS comments at 5 (emphasis added). As ORS recognizes, deferrals are appropriate where the costs at issue are "unusual or extraordinary." Their unusual or extraordinary nature, however, does not mean that the costs will not be recurring. For example, a new, unanticipated regulation could require the Companies to make recurring capital investments or take on operational tasks which were previously not required. While such investment would be unexpected and therefore would not have been a factor in setting rates in a past rate case, it could also be recurring until the time that the utility can file another rate case in which those recurring costs could be captured in rates on an ongoing basis. Similarly, if a normal business expense dramatically increased—for example, an unexpected increase in costs for spent nuclear fuel disposal due to a change in law or regulation—the utility should not be denied a deferral request simply because an expense is what would be otherwise considered a "normal" (i.e., not unusual) business expense. As explained in the Companies' third proposed guideline, a more appropriate consideration in this context is whether the expense is necessary, could not have been reasonably anticipated by the utility, or is beyond the utility's control. Comments of DEC and DEP at 5-6. Ultimately, deferral accounting is a useful tool for bridging the gap between the incurrence of unusual or extraordinary costs and when new rates from a rate case can be implemented to recover those costs. While evaluating whether the costs are recurring in nature or unexpected in the normal course of operations are useful considerations, both of these factors need not exist for a deferral to be appropriate to permit a utility to bridge the gap until the amounts have been reflected in rates.

Moreover, an undue focus on whether a cost is unexpected and non-recurring, as proposed by ORS, can actually have a negative effect on the goals articulated by ORS on pages 2 to 3 of its comments. While ORS asserts an interest in ensuring continued utility investment facilities to provide high-quality and reliable utility service, and in mitigating risk to utility customers, these goals would be undercut by an evaluation that turns simply on whether the costs are unexpected and non-recurring. In evaluating a deferral request, the Commission's analysis should not be limited to simply determining whether the costs are unexpected and non-recurring, which would undermine the broader goal of serving the public interest. Instead, the Commission has available to it a set of considerations for evaluating whether deferral accounting is appropriate in a particular context, including whether the costs being deferred will create savings for customers or result in other operational benefits, and whether the deferral helps advance any technological improvement, modernization or compliance with applicable law or regulation. These considerations—along with the others discussed in the Companies' comments—may be entirely divorced from whether the associated expenses are unexpected and non-recurring, but they would nevertheless serve the public interest by mitigating risk to customers and ensuring high-quality and reliable utility service.

D. Carrying costs are an incurred cost of the utility.

The Companies challenge ORS's assertion that "[a] utility should not be allowed to accrue carrying costs on the deferral balance or accrue a deferred return associated with capital expenditures because the carrying cost and deferred return are not an incurred cost of the utility." Contrary to this position, carrying costs on the deferral balance and the deferred return on capital expenditures are an actual cost incurred by the utility. Costs incurred by a utility under a deferral, whether designated as capital or operating expense for accounting purposes, require cash. Such

cash must be obtained from a utility's debt and equity investors, who require interest, or a return, on the cash they have invested in the company. These financing costs (carrying costs and the return on the deferred costs) are an actual cost that utilities incur and to disallow recovery of these costs during the deferral period or the amortization period would be to disallow prudently incurred costs. *See, e.g.*, *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (classifying service on the debt and dividends on the stock as "capital costs of the business"). In ENERGY, ECONOMICS AND THE ENVIRONMENT, the authors explain:

> At its most basic level, a rate of return represents the utility's cost of capital—i.e., the opportunity it foregoes by using its capital to provide utility services rather than engage in some other profitable activity. Cost of capital can be broken into two main components: 1) the cost of money that is borrowed on both a long- and short-term basis, also known as "debt"; and 2) money received by the utility in exchange for its stock, or "equity."

FRED BOSSELMAN, ET AL., ENERGY, ECONOMICS AND THE ENVIRONMENT 89-90 (2nd ed. 2006). Likewise, in James Bonbright's PRINCIPLES OF PUBLIC UTILITY RATES, the author explains:

> [A] company that cannot meet its costs of capital, including its fixed charges plus "reasonable" dividend requirements, cannot long continue to supply adequate public utility service to a growing community—not, at least, without violation of express or implied commitments that it has already made in order to secure capital for the construction of its existing plant. In an extreme case, to be sure, failure to cover existing costs of capital may ultimately be cured, from the standpoint of the community, by a drastic financial reorganization under the National Bankruptcy Act or otherwise. But the cure is costly, prolonged, and painful.

JAMES C. BONBRIGHT, PRINCIPLES OF PUBLIC UTILITY RATES 241 (1961). So not only would an improper disallowance of financing costs prevent the utility from recovering prudently incurred costs, such disallowance compromises the utility's ability to attract and secure capital. These principles as applied to a utility's financing costs are addressed within a rate case by the setting of rates that are adequate to permit the utility's recovery of its investment and financing costs (i.e., rate of return), and, following the rate case, recovery occurs contemporaneous to the investment.

But when the utility undertakes investment that is not captured in rates, without an accounting mechanism that permits recovery of all the costs of such investment—including the financing costs—the utility is unable to cover its costs of capital.

In the Commission's recent order in the DEC rate case proceeding, the Commission articulated the following:

> The purpose of this regulatory scheme of using a test year and making adjustments based on atypical conditions is to permit sufficient and accurate cost recovery as the expenses are incurred by the utility in real-time. In other words, the purpose of this ratemaking exercise of using a test year and making appropriate adjustments is to match—as closely as possible—the utility's revenue to the costs it will incur after the rates are implemented. In that regulatory context, there is no need to consider the time value of money or the carrying costs of debt because the utility's revenue matches its expenses as they are incurred.

Order No. 2019-323, Docket No. 2018-319-E at 15-16 (May 21, 2019) (emphasis added) (citing *Southern Bell Tel. & Tel. Co. v. S.C. Pub. Serv. Comm'n*, 270 S.C. 590, 602 (1978)). Deferral accounting fulfills the goal of "sufficient and accurate cost recovery" by accounting for expenses that are not already captured in rates. Because these expenses are **not** already reflected in rates, there **is a need** "to consider the time value of money or the carrying costs of debt because the utility's revenue [**does not**] match[] its expenses as they are incurred." *Id.* As the Commission has previously pointed out, the Commission bears a dual responsibility of permitting utilities an opportunity to earn a reasonable return (a) "on the funds devoted to [serving the public] as that would constitute a taking of private property without just compensation[, and] (b) Not permitting rates which are excessive." Order No. 2019-341 at 22, Docket No. 2018-318-E (May 21, 2019) (emphasis added) (quoting *Southern Bell Tel. & Tel. Co. v. S.C. Pub. Serv. Comm'n*, 270 S.C. 590, 605 (1978)). Such funds that are devoted to serving the public are not only those which are already included in rates, but also those which are invested prior to their inclusion in rates and which are being tracked through deferral accounting.

"Capital" as used in the above-referenced caselaw and ratemaking authorities refers to the money invested by the utility, not only that which has been invested in "hard assets."[1] Recovery only of the financing costs necessary for investment in hard assets would be an arbitrary standard with little relation to the actual costs incurred by the utility. Instead, the cost of capital, as explained in ENERGY, ECONOMICS AND THE ENVIRONMENT, is literally the cost of money, and it represents the value of other foregone opportunities by investors and debt-holders. Contrary to ORS's recent position in the Companies' rate cases, the standard of whether to permit a reasonable return on the investment is not whether the costs incurred are capital-related, but instead whether the expenditures were incurred in the service of the public. These amounts, by definition, necessarily include carrying costs on expenses incurred by the utility, and this position is consistent with the right of a utility to "a fair return on the value of its property used in the service." *Southern Bell Tel. & Tel. Co. v. Pub. Serv. Comm.*, 270 S.C. 590, 595 (1978) (quoting 64 Am.Jur.2d, Public Utilities, § 189). Further—to the extent it has any relevance whether the costs are capital-related—the accounting standard that allows utilities to defer costs and record regulatory assets permits utilities to capitalize deferred expenses; for that reason, all deferred expenses are capitalized and are therefore "capital-related."

The Companies agree with ORS that the Commission has an opportunity to review the prudency and reasonableness of deferred costs in a future rate case in which cost recovery is requested. However, as explained above, utilities should be permitted to recover the carrying costs on prudently incurred expenditures in order to ensure that the utility's revenue matches its expenses as they are incurred. Permitting a utility to establish a deferral account but then later

[1] The first two definitions of "capital" in Black's Law Dictionary are as follows: (1) Money or assets invested, or available for investment, in a business; and (2) the total assets of a business, esp. those that help generate profits. BLACK'S LAW DICTIONARY (11th ed. 2019).

denying it the opportunity to recover its carrying costs on prudently spent monies which are not recovered in current rates would deny the utility the opportunity to recover the costs associated with serving customers.

E. A deferral should provide some indication that the expense is of the type appropriate for recovery.

The Companies challenge Nucor's position that "all issues related to the deferral (not just the prudence of the deferred cost)" should be revisited and reconsidered in the utility's next rate case without any deference to or consideration of the fact that deferred accounting was permitted. Deferrals are a tool historically used by the Commission and participating parties to delay or mitigate rate increases and address newly incurred costs not included in current rates. Deferrals can facilitate the implementation of new systems and programs that benefit customers, such as advanced metering technology,[2] more efficient billing systems,[3] and more expeditious regulatory compliance, such as compliance with cybersecurity and nuclear safety requirements.[4] However, if the Commission were to grant the establishment of a deferral but then reconsider the granting of the deferral in a future rate case, such a "deferral" would provide essentially no value to the utility.

The Companies' external auditors require that the deferred costs be probable of recovery in future revenues in order for the utility to establish a regulatory asset and record a deferral. The deferred costs can still be subject to review for reasonableness and prudence, like other utility investments, and nevertheless be considered "probable of recovery." However, if the question of whether or not the deferral should have been granted remains open *even after the deferral was*

[2] *See* Order No. 2018-553, Docket No. 2018-205-E (Aug. 9, 2018).

[3] *Id.*

[4] See Docket No. 2013-472-E, Order No. 2016-36 (2016).

granted, it will be difficult for the utility to meet this probability of recovery in future revenues standard, meaning the utility would no longer be able to use deferrals to benefit its customers, invest in the same manner between rate cases, or even delay rate cases. The benefits of delaying rate cases would be eliminated, and the systems and programs that depend upon the establishment of a deferral would no longer be an option for utilities or their customers. While, as stated above, the Companies agree that the Commission has an opportunity to review the *prudency and reasonableness* of specific deferred costs in the future rate case in which cost recovery is proposed, the Commission's decision whether or not to permit the deferral of the costs in the first place should be final and not subject to reconsideration in the future rate case.

F. South Carolina should develop its own policy, but to the extent it looks to the North Carolina Utilities Commission (the "NCUC") for guidance, the NCUC evaluates deferral requests on a case-by-case basis.

As noted by ORS, the NCUC has utilized a two-part test for evaluating deferral requests: whether the costs in question are unusual or extraordinary in nature, and whether, absent a deferral, the costs would have a material impact on the utility's financial condition. However, the NCUC has recently stated that its two-part test "is not the exclusive factor in considering a deferral request."[5] To the contrary, the NCUC concluded that it "may analyze the merits of deferral using not only the well-established two-prong test but also considering the totality of the underlying facts, circumstances, and equities" applicable in a particular case.[6] Likewise, as the Companies discussed in their comments filed in this proceeding, there is a variety of factors relevant to the

[5] *Order Allowing Deferral Accounting, Denying Public Staff's Motion for Reconsideration, Granting Transfer of CPCNs, and Qualifying the Transferred Facilities as New Renewable Energy Facilities* at 18, Docket No. E-7, Sub 1181, N.C.U.C. (June 5, 2019).

[6] *Id.*

Commission's evaluation as to whether a particular deferral request would be appropriate in a particular context.

It is also worth clarifying Nucor's assertion that the NCUC's position is that deferrals should be granted only "sparingly." The Companies are aware of no fewer than 20 separate deferrals that the NCUC has granted the Companies over the past 11 years.[7] Therefore, the

[7] *Order Approving Deferral Accounting With Conditions*, N.C.U.C. Docket No. E-7, sub 874 (Mar. 31, 2009) (approving for DEC deferral accounting as related to (1) environmental compliance equipment at Allen and (2) purchase of ownership interest in the Catawba Nuclear Station); *Order Approving Deferral Accounting*, N.C.U.C. Docket No. E-7, sub 966 (June 27, 2011) (approving for DEC deferral accounting as related environmental compliance equipment at Cliffside); *Order Approving Deferral Accounting*, N.C.U.C. Docket No. E-7, sub 999 (June 20, 2012) (approving for DEC deferral accounting as related to (1) costs associated with the addition of Buck CC and (2) costs associated with the addition of Bridgewater Hydro); *Order Approving in Part and Denying in Part Request for Deferral Accounting*, N.C.U.C. Docket No. E-7, sub 1029 (Apr. 3, 2013) (approving deferral for DEC accounting as related to (1) costs associated with the addition of Cliffside, (2) costs associated with the addition of Dan River, and (3) incremental depreciation expense associated with the addition McGuire uprates); *Order Granting General Rate Increase*, N.C.U.C. Docket No. E-7, sub 1026 (Sept. 24, 2013) (approving for DEC deferral accounting as related to (1) the costs to implement a lighting audit and billing system change, (2) the levelization of expenses associated with nuclear unit refueling outage expenses); *Order Granting General Rate Increase*, N.C.U.C. Docket No. E-2, sub 1026 (May 30, 2013) (approving for DEP deferral accounting as related to the levelization of expenses associated with nuclear unit refueling outage expenses); *Order Approving Deferral Accounting for Wayne CC and Denying Deferral Accounting for Richmond CCC*, N.C.U.C. Docket No. E-2, sub 1026 (Mar. 22, 2013) (approving for DEP deferral accounting as related to the post-in-service costs for Wayne CC); *Order Approving Request for Deferral Accounting*, N.C.U.C. Docket No. E-2, sub 1035 (Sept. 16, 2013) (approving for DEP deferral accounting as related to the development of Harris 2 and 3); *Order Approving Deferral Accounting*, N.C.U.C. Docket No. E-2, sub 1049 (Mar. 30, 2015) (approving for DEP deferral accounting as related to unrealized gains and losses associated with interest rate management agreements); *Order Approving Deferral Accounting*, N.C.U.C. Docket No. E-2, sub 862 (Mar. 30, 2015) (approving for DEC deferral accounting as related to unrealized gains and losses associated with interest rate management agreements); *Order Accepting Stipulations, Deciding Contested Issues and Granting Partial Rate Increase*, N.C.U.C. Docket No. E-2, sub 1131 (Feb. 23, 2018) (approving for DEP deferral accounting as related to (1) coal combustion residuals, (2) 2016 storm costs, (3) Customer Connect program costs, and (4) the cost of replacing AMR meters with AMI meters); *Order Accepting Stipulation, Deciding Contested Issues, and Requiring Revenue Reduction*, N.C.U.C. Docket No. E-7, sub 1110 (June 22, 2018) (approving for DEC deferral accounting as related to (1) post-in-service costs associated with Lee CC, (2) Customer Connect program costs, and (3) coal combustion residuals); *Order Allowing Deferral Accounting, Denying Public Staffs Motion for Reconsideration, Granting Transfer of*

NCUC's practice has been to permit several deferrals every few years, rather than, for example, one every 10 years. In general, moreover, how often the Commission grants deferral requests, or how many deferral requests a utility has made within a particular span of time, has essentially no bearing on the merits of deferral requests, which should be considered on a case-by-case basis.

G. A "five percent" threshold does not bar deferral accounting for lesser amounts.

While ORS is correct that the NCUC has determined that items representing more than 5 percent of a utility's income are generally considered to be extraordinary, this 5 percent level is a threshold at or above which the expense is considered to be extraordinary – and it makes sense to have a threshold that, once reached, disposes of any question of whether expenses are "extraordinary." However, it is not true and should not be a maxim that anything under 5 percent is not extraordinary and would not have a material impact on earnings, especially if the requesting utility is already reporting returns below its allowed cost of capital. The definition of the word "extraordinary" only requires that the expenses be "out of the ordinary," and such definition does not require or imply that the expenses must be extreme.[8] Therefore, as explained in the Companies' proposed guidelines, what is significant enough to warrant a deferral can be subjective and should be evaluated based on the facts and circumstances of the request. One notable omission from ORS's comments is that both the NCUC and Federal Energy Regulatory Commission ("FERC") may determine that expenses below 5 percent can also be considered extraordinary if

CPCNs, and Qualifying the Transferred Facilities as New Renewable Energy Facilities, N.C.U.C. Docket No. E-7, sub 1181 (June 5, 2019) (approving for DEC deferral accounting as related to the loss on the disposition of certain hydro units).

[8] Black's Law Dictionary, "Extraordinary" ("Out of the ordinary; exceeding the usual, average, or normalmeasure or degree.").

deemed so by the NCUC or the FERC. Indeed, the FERC standard permits the regulatory body to find that items making up less than 5 percent of the utility's income are extraordinary.[9]

It should also be pointed out that a utility could have multiple unanticipated expenses that collectively accrue to greater than 5 percent of their respective annual revenue requirements and therefore collectively have a material impact on the utility's financial condition and outlook. For that reason, limiting accounting orders to amounts of greater than 5 percent would be an arbitrary and imprecise way to track funds that are used in service to the public and that are not reflected in rates.

As explained in the Companies' proposed guidelines, the appropriate standard for evaluating whether certain expenses are significant enough to warrant deferral accounting—as previously used by the Commission—is whether denial of the accounting request could adversely affect the utility's earnings as compared to the most recently allowed return set by the Commission. This position is supported by the general principle that a utility possesses "the right . . . to a fair return on the value of its property used in the service." *Southern Bell Tel. & Tel. Co. v. Pub. Serv. Comm.*, 270 S.C. 590, 595 (1978) (quoting 64 Am.Jur.2d, Public Utilities, § 189). The Companies submit that the public interest will continue to be served by that approach.

H. That expenses may be estimated or contingency expenses have no bearing on materiality or ability to defer.

Although ORS asserts that deferral accounting treatment should not be granted for "estimated expenses or contingency amounts," this doesn't make sense as applied to deferred expenses. For example, storm repair costs often are not fully realized until the work is done, which

[9] 18 CFR Pt. 101, FERC Uniform System of Accounts, General Instruction 7, Extraordinary Items ("Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary.").

can take months and sometimes years. It is reasonable to expect a utility to estimate a deferral amount in requesting a deferral, and even report on the balance in the interim (as this Commission has required in the past), and material deviations from expected costs for any matter should be carefully evaluated. However, it is not practical to require perfect precision on the deferral of costs as they are being incurred. The precise amount of the ultimate deferral balance is typically not precisely known until after (1) deferral accounting treatment has been approved by the Commission, and (2) the costs have actually been incurred. In fact, whether the Commission will approve deferral accounting for a particular investment can determine whether the utility decides to move forward or not with the proposed project. Commission approval in those cases is necessarily based on pre-incurrence estimates rather than post-incurrence balances. Further, because the Commission and other interested stakeholders have the opportunity to evaluate the prudency of the incurred expenses during a rate case, or to request updates or reports in the interim, there is no need to restrict the Commission from approving deferral requests based on estimated or contingency amounts. Because the Commission and the ORS later have the opportunity to evaluate the prudency of the deferred expenses during a rate case—i.e., prior to the associated costs being passed on to customers—preventing the Commission from granting deferral requests for estimated or contingency amounts could unnecessarily prevent the implementation of programs that are in the public interest. As ORS points out, expenditures associated with the deferrals could result in customer savings; the Companies agree that known and measurable savings accruing during the deferral period could be booked to the deferral account to offset the final deferral balance.

ORS asserts that "a date should be established by which the utility should begin amortization such that the balance of the deferred costs is not recorded on its books without

amortization for an unspecified period." As support, ORS states that the "NCUC requires amortization for storm restoration and repair costs to begin in the month the storm occurs."[10] However, this has only been required in one order from the NCUC since 2005 and resulted in DEP having to write-off a significant portion of the deferral. It is important to note that since 2005 external audit firms have issued clarifying guidance stating that they do not consider it a legitimate deferral if the company has to begin amortization without a corresponding increase in customer rates. If such treatment were granted by the Commission, they would not allow the utility to record the deferral and instead would require the utility to take an immediate hit to income. In its Utilities and Power Companies Guide,[11] PricewaterhouseCoopers ("PwC") gives guidance on the following question, "Does an accounting order (without a rate order) provide sufficient support for recognition of a regulatory asset or liability?" In its response, PwC states, "An accounting order to amortize a regulatory asset or other cost with no impact on revenues does not provide the cause and effect relationship between costs and revenues required to create a regulatory asset." The Companies' external auditor, Deloitte, in its 2005 Accounting, Financial Reporting and Tax Update publication, gave consistent guidance by stating that "Regulatory assets should be amortized over future periods consistent with the related increase in customer revenues." This guidance was reaffirmed in Deloitte's 2012 Regulated Utilities Manual that deferral is appropriate "when it is probable that the costs will be recoverable out of future revenues" and further states

[10] ORS Comments at 7 (citing NCUC Docket No. E-2, Sub 1193).

[11] PricewaterhouseCoopers, Utilities and Power Companies Guide at 17-15 (Dec. 2018), *available at* https://www.pwc.com/us/en/cfodirect/assets/pdf/accounting-guides/pwc-guide-utilities-power-companies.pdf)

that such a deferral is "in conformity with the principle of matching costs with revenues."[12] Under the literature and interpretations cited above, a deferral where amortization is required without a corresponding increase in revenues would have to be expensed immediately if the utility does not have an upcoming planned rate case. If the utility does have a planned rate case, the accounting guidance would require the utility to write-off the estimated amortization that would occur before new rates from that rate case are expected to be effective. Therefore, if the Commission were to adopt such a practice, the effect would be to potentially eliminate the practicability and usefulness of deferrals, which would be to the detriment of customers.[13]

However, the Companies understand that deferrals should not extend into infinity – it is reasonable to require a utility to come in for a rate case within a foreseeable time frame, depending upon the circumstance, to ensure timely recovery of the deferral or else start amortizing such balance, as well as to minimize the accrual of returns. In fact, that is also a mechanism that utilities have abided by in the past. For example, in 2013, the NCUC approved DEP's proposal to defer costs associated with the cancelled development of units 2 and 3 of the Shearon Harris Nuclear Station. The approved deferral proposal required DEP to either (1) file a rate case within five years proposing recovery of these costs, or, (2) if the rate case was not filed, fully amortize the balance

[12] Deloitte, Regulated Utilities Manual: A Service for Regulated Utilities at 25 (2012), *available at* http://ipu.msu.edu/wpcontent/uploads/2017/09/Deloitte-Regulated-Utilities-Manual-2012-2.pdf.

[13] On a case-by-case basis, utilities could commit to beginning a deferral's amortization within a fixed amount of time (e.g., within 5 or 10 years), but it is necessary when assigning a particular start date for a deferral amortization, that the duration of the amortization period be determined at the same time to ensure that the utility knows the amount to amortize each month. In general, however, as is the Commission's current practice, no time limit should be placed on the start of the amortization, as such would be arbitrary and serve no real benefit.

at the end of ten years from the date of the project's cancellation.[14] Such an arrangement, in the appropriate circumstances, would satisfy ORS's interest in amortizing deferred costs within a specified period.

Amortization of deferred balances should begin after new rates take effect following a rate case whereby the deferred costs were incorporated into cost of service, or else at a fixed point in the future by which the utility could prepare and file a rate case. Amortizing costs retroactively without a corresponding increase in revenues would deprive the utility of an opportunity to recover its prudently incurred expenditures and would create an inequitable mismatch between the utility's revenue and its expenses. For example, it would be unfair to require amortization of an extraordinary expense incurred for the benefit of customers when the utility has no ability to seek recovery for it, such as during the 12-month stay out provision mandated by South Carolina law, which is not applicable in the other states referenced by ORS, such as North Carolina.

ORS also discussed, in its comments, a concern about the utility "receiving a windfall" should a utility continue to recover expenses over the amount necessary to cover its incurred costs. The Companies do not object to continuing to record amortization expense until it can be removed from revenue in a rate case. That amortization expense could be applied to additional deferred balances to ensure that customers receive the benefit and that expenses are matched with revenue. The Companies are not advocating for deferral accounting to create a "windfall" situation, but rather to keep utilities whole on prudently incurred expenses until such time they can be sought for recovery in rates.

[14] *Order Approving Request for Deferral Accounting*, Docket No. E-2, Sub 1035, N.C.U.C. (Sept. 16, 2013).

I. The guidelines offered by the Companies are sound, relevant, and useful.

In the Companies' comments in this proceeding, the Companies offered a set of guidelines that should be considered in the Commission's evaluation of deferral requests. While each guideline may not be applicable to every deferral request, the Companies submit that all of these considerations are sound, relevant, and useful in considering whether deferral accounting treatment is appropriate in a particular context.

In its filing, ORS submits that the Commission's action in this proceeding should (1) promote efficient use of Commission resources by providing a framework to assess deferral requests; (2) streamline the inspection, audit and examination of public utilities; (3) enhance transparency of the utility rates and services; (4) ensure continued utility investment facilities to provide high-quality and reliable utility service; and (5) mitigate the risk to utility customers. The guidelines proposed by the Companies would serve the goals offered by ORS, but also afford the Commission wider latitude in determining whether a utility's expenses are appropriate for deferral accounting.

Ultimately, as ORS points out, the Commission has discretion to determine what qualifies and doesn't qualify as "just and reasonable standards, classifications, regulations, practices, and measurement of service to be furnished, imposed or observed, and followed by every public utility in this State." ORS Comments at 1-2 (quoting S.C. Code Ann. § 58-3-140(A)). The Companies submit that, in making this determination in the context of deferrals, the Commission should leave itself discretion to act in the public interest. ORS's comments neglect other considerations that have a direct impact on the public interest, for example, the delay and reduction of rate cases (and associated rate case expenses), utilities' ability to invest in facilities and programs to the benefit of customers, utilities' prompt compliance with laws and regulations, and other investments that

could create customer savings. The Companies believe that the Commission's evaluation of whether permitting a deferral request would be just and reasonable or would be in the public interest requires more than the narrow focus offered by the ORS, and should include the various considerations proffered by the Companies in their proposed guidelines.

II. Conclusion

When the appropriate circumstances exist and customers would benefit, the Commission can—on a case-by-case basis—authorize the use of deferral accounting in order to bridge the gap between the incurrence of unusual or extraordinary costs and when new rates from a rate case can be implemented to recover those costs. The Commission's issuance of guidelines consistent with those proposed by the Companies will enable the Commission to act in the public interest and ensure the establishment of just and reasonable standards, classifications, regulations, practices, and measurement of service to be followed to by South Carolina utilities.

Respectfully submitted,

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